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EFFECT OF EXTERNAL BUSINESS ENVIRONMENT ON GROWTH OF MICRO AND SMALL ENTERPRISES IN KENYA

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Abstract

Business enterprises do not operate in isolation hence there is need for creation of linkages with external networks. These linkages would enhance the likelihood of managing costs associated with reaching to heterogenous business stakeholders. Further, from these linkages micro and small enterprises would create avenue for understanding their clients' needs and opportunities to manage their operational costs. Thus, the current study examined the effect of external business environment on growth of micro and small enterprises in Kenya. The study was based on path goal leadership theory. Descriptive research design was applied and primary data gathered through administration of questionnaires. Data was subjected to descriptive statistics through use of SPSS. The findings indicated that external business environment has effect on growth of micro and small enterprises in Kenya. It was concluded that there is need for creation of horizontal and vertical external environment linkages so as to optimize growth of MSEs.

Keywords; Business, external, environment, enterprises, growth

INTRODUCTION

The World Bank researchers argued that constrains that are facing the growth of MSEs are complex tax systems, lack of access to finance, lack of requisite human capital and inability to adopt governance system that will embrace change (Chadamoyo and Dumbu, 2012). Also, another shortcoming in South Eastern Europe is low level of trust in the court system to enforce claims, and the need to pay significant bribes for access to basic public services. For MSEs to close the gap with their larger counterparts in the world of technology, further action by regional governments will be required.

Martins and Rialp (2013) suggested that external environment due to its acknowledged importance is a critical moderating variable in the EO-performance correlation. Additionally, within the premises of contingency theory external environment (EE) is considered as a key moderating variable for any successful strategy implementation. Based on this study, Rocha (2012) indicated that a simplified business environment, supported by fiscal and budgetary policies could support the development of MSEs. Ghani et al., (2010) studied the critical internal and external factors of business environment in Malaysia and found that external factors which become opportunities for companies are supported and encouraged by the government, and the threats are represented by bureaucratic procedures that companies must face to obtain various approvals and certifications.

Chadamoyo and Dumbu (2012) investigated the influence of business environment and competitive strategy on SMEs in Mucheke light industry. The research results revealed that the innovation strategy, cost and competitive advantage are the key competitive strategies of SMEs, business environment being a tough one in terms of legal factors, social, political and economic. Another conclusion is that SMEs should seek strategic alliances to cover many markets, to properly manage Key Performance Indicators (KPI), and the government to relax regulations on SMEs sector.

New governments usually formulate new policies that affect businesses including SMEs for example, the Jubilee government has come with new policies of lending women and youth SMEs money at Zero interest rates (Jubilee manifesto, 2012). This is yet to be implemented but at least the lending rates would be good and encouraging to the borrowers. These policies are likely to attract the formation of new SMEs which would increase competition in the sector. The competitive environment would make the SMEs to work harder in innovating new products to gain competitive advantage. The political stability is also important to SMEs because it ensures a good business environment. The political conflict of 2007/2008 will live as a testimony of the effects of political instability on businesses both large and small.

LITERATURE REVIEW

Path Goal Leadership Theory

Path goal theory of leadership was developed by Evans (1970) and House (1971). The theory argues that leadership is aimed at enhancing the level of employee's motivation as they pursue organization goals and objectives. To motivate organization employees there is need for creation of non-hygienic environment. In pursuance of employee motivation, there is need for creation of networking opportunities that would develop an avenue for information and resources sharing. According to House (1971) path goal theory should be perceived as two-edged sword where motivation is only achievable if there is a harmonious relationship between subordinate and superiors in an organization. This will be possible if there is harmony between internal and external motivating factors of employees in respective organizations.

The theory is appropriate in the study since micro and small enterprises leadership have crucial role in creation of networks that are crucial for the survival of their respective enterprises. Alternative measures ought to be adopted to develop and nurture networking among micro and small enterprises that are operating in different sectors. This would create an opportunity for accessing different services and goods at affordable and reliable prices.

Empirical Review

Okwu, Bakare and Obiwuru, (2013) in their study (Business Environment, Job Creation and Employment Capacities of Small and Medium Enterprises in Lagos State, Nigeria: The study had emphasizes that the business environment in which SMEs operate has a particular, special relevance for their abilities to create jobs and provide employment opportunities. This study used a descriptive approach to examine the ability to create jobs in the SMEs sector in the economy of Lagos, Nigeria. The analysis was based on ten elements characteristic of business environment and two indicators of SMEs relevance. The research showed that the small business sector is dominant. The findings may not be generalized in local perspective since the business operating environment for Kenya and Nigeria are different hence, the need for localized study.

Barth, Caprio, and Levine (2013) in a cross-country survey examined the relationship between specific regulatory and supervisory practices with banking-sector's development, efficiency and fragility using a new data base regulations and supervision in 107 countries including Kenya. Their findings raised a cautionary flag regarding Basel II pillars 1 and 2, as they found no statistically significant relationship between capital stringency, official supervisory power and bank performance. They argued that countries reduced the likelihood of corruption in lending by adjusting bank regulation to facilitate private monitoring of banks. Since enterprises operate in heterogeneous environment there is need for creation of opportunities that may guide how enterprises from different sectors may form formal and informal groups to amplify their growth.

Business growth is typically defined and measured using absolute or relative changes in sales, assets, employment, productivity, profits and profit margins. Therefore, sales growth need not correspond to or underpin other dimensions of growth in which policy makers might also be interested; for instance, sales can increase while employment and/ or profits fall. This is partly related to contextual or structural issues such as sector or age of business but also to the strategic choices made by principal decision makers in the firm. In practice, sales growth is also easier compared with some other indices and is much more likely to be recorded. Sales are a good indicator of size and therefore growth. Sales may also be considered a precise indicator of how a firm is competing relative to that market. Business owners themselves often treat sales as key motivator and indicator of performance rather than, for example, job creation, (Koech 2011).

A number of factors affect the growth of African MSEs, including the business environment and the quality of the labour force. However, a crucial element in the development of the MSE segment is access to finance, particularly to bank financing, given the relative importance of the banking sector across the continent. African MSEs are more financially constrained than in any other developing region (Stephanou & Rodriguez, 2010). Only 20 percent of MSEs in Sub-Saharan Africa have a line of credit from a financial institution compared, for example, with 44 percent in Latin America and Caribbean, and only 9 percent of their investments are funded by banks versus 23 percent in Eastern Europe and Central Asia. The study found that the MSE is a strategic priority for the banks in the region. MSEs are considered a profitable business prospect and provide an important opportunity for cross-selling.

A study conducted by Kinyua (2014) in Nakuru Town sought to investigate factors affecting the performance of small and medium enterprises in the *Jua Kali* Sector in Nakuru town. It sought to investigate the role of finance, management skills, macro-environment factors and infrastructure on performance of small and medium-sized enterprises in the *Jua Kali* sector in Nakuru town. The findings show that; that access to finance had the potential to positively affect performance of SMEs; management skills were found to positively and significantly affect performance of SMEs; macro environment factors were found to significantly affect performance and Infrastructure did not significantly affect performance of SMEs in the study area. The study recommended that banks should improve access to finance through offering better lending terms and conditions and collateral requirements; focus on acquiring appropriate management skills such as financial, marketing and entrepreneurial skills and effectively strengthen the macro environment in order to increase SMEs performance.

RESEARCH METHODOLOGY

Descriptive research design was applied in the study while examining the effect of external environment on growth of micro and small enterprises in Kenya. According to Cooper and Schnidler (2014) descriptive research design is most applied in studies that aims at responding to questions on who, when, why and how in regards to items under examination. In this study the target population was 519 835 beneficiaries of micro and small enterprises programs that were coordinated by micro finance institutions in Kenya. Simple and stratified sampling techniques were used in sample size selection. Yamane (1978) sample size formula was applied as shown:

$$n = \frac{N}{1+N(e^2)}$$

Where: n = required sample size

N = Target population

e = margin of error at 5% (standard value of 0.05)

Therefore, the sample size was,

$$n = \frac{519385}{1+ 519385\ (0.05^2)} = 400$$

Since, entrepreneurs have ventured into different business the current study adopted proportionate stratified sampling to select respondents from manufacturing, service, trade and others from which 10, 137, 150 and 103 respondents were drawn from.

Table 1 Sample Size

Population Category	Target Population	Percentage	Sample size
Manufacturing	13232	3	10
Service	177421	34	137
Trade	194783	38	150
Others	133949	26	103
Total	**519385**	**100**	**400**

(Source: MSEA, 2018)

Primary data that was collected through use of semi structured questionnaires were used in the study. According to Sekaran and Bougie (2013) questionnaires are dominant mostly in social sciences because they are easier to administer and do not require personalized attention while gathering the data. Descriptive statistics adopted in the study include mean, frequency, percentages and standard deviation. Data analysis was carried out through use of Statistical Packages for Social Scientists (SPSS, version 22).

FINDINGS AND DISCUSSION

Descriptive Analysis on External Environment

The fifth objective investigated the effect of external environment on micro and small enterprises growth in Kenya. Respondents rating was sought on a five-point Likert scale as shown in Table 2. Descriptive statistics using mean, standard deviation, frequency and percentage were used to summarise the data. From the findings it can be inferred majority mean = 3.9, 4, 4.1, 4.1, 4.2, 4.1, 4 and 4.1 respectively agreed that external environment contributed to decreased number of transactions, decreased number of customers worn, failure to deliver goods and services, reduced price of goods and services, increased quality of production, uncertainty in business environment and increased taxation and tariffs.

These findings concurred with sentiments that, external business environment is a major driver that impact on all business including SMEs. According to Dzisi et al., (2014) SMEs in developing countries are vulnerable to external business environment effects. He said, the challenges the SMEs face can be attributed to macro environmental factors, competitive forces and strategic group competition.

Table 2 Descriptive Analysis on the Effect of External Environment on Micro and Small Enterprises Growth in Kenya

	Percentage (n=322)						
	SD	**D**	**NAD**	**A**	**SA**	**Mean**	**Std. Deviation**
Decreases the number of transactions	0.9	5.9	5.9	73.9	13.4	3.9	0.7
Decreases the number of customers won	0.3	7.5	3.7	68.6	19.9	4	0.8
Lead to failure to deliver of goods and services	1.6	8.1	3.4	56.8	30.1	4.1	0.9
Reduces the prices of goods and services	3.1	3.7	2.8	63	27.3	4.1	0.9
Increases the quality and cost of production	1.6	4.7	1.9	61.5	30.4	4.2	0.8
Creates uncertainties in the market	2.2	4.3	1.9	69.3	22.4	4.1	0.8
Increases taxes and tariffs	5.3	4	3.1	64.6	23	4	0.9
Overall average						**4**	**0.8**

**SD: Strongly disagree, D: Disagree, NAD: Neither Agree nor Disagree, A: Agree, SA: Strongly Agree*

Measures Taken to Improve Enterprises Competitive Advantage amongst Micro and Small Enterprises in Kenya

Further, the study investigated measures taken to improve enterprises competitive advantage after the training. Through training it is anticipated an entrepreneur will acquire skills which will aid in attainment of superior performance. Results in Table 3 revealed that 75.2% of respondents reported additional if greater value through innovation, 27% reported controlled visits to their competitors and 35.7% reported enhancement of overall in-house experience. These findings mirrored past empirical scholars who argued that innovation also plays a crucial role in now day business and it is regarded as a key characteristic of SMEs, mainly due to the attitude of the manager. Innovative companies are able to respond within the bounds of the knowledge about existing products or services to changes required by the customer within their niche market (Chadamoyo & Dumbu, 2012).

Table 3 Measures to Improve Competitive Gap after Entrepreneurial Training amongst Micro and Small Enterprises in Kenya

	Frequency	**Percentage (n/322)**
By adding greater value through innovation	242	75.2
By making the process of visiting a competitor routine and controlled	87	27.0
By enhancing the overall in-house experience	115	35.7

Effect of Competition on Business Operation among Micro and Small Enterprises in Kenya

MSEs do not operate in isolation; they run their operations in a competitive environment. Consequently, this investigated the effect of competition on business operations amongst MSEs in Kenya. Results shown in Table 4 revealed that 50.6% reported decrease in their prices, 40.4% reported introduction of product ranges and services or they intensified their marketing. Majority 79.5% reported that they emphasised more on customer satisfaction. These findings were in congruent with Gunasekaran et al. (2011) who argued that competition increases prices, this is because the competitive standards change continuously due to consumers changing needs and expectations, technological developments and globalization of markets. Furthermore, these findings concurred with provision of blue ocean strategy which stipulates on the need to discover new markets which are purely demand driven and firms would face least resistance from their respective competitors.

Table 4 Effect of Competition on Business Operation among Micro and Small Enterprises in Kenya

	Frequency	Percentage (n/322)
Lower prices	163	50.6
Greater range of services	130	40.4
More advertisement	130	40.4
Customer satisfaction	256	79.5

CONCLUSION AND RECOMMENDATIONS

Business networking opportunities provides an avenue for information exchange and gathering of requisite resources that if adopted in an enterprise would enhance its likelihood of survival. Enterprises that would remain as a going concern should have clear mechanisms on how they can create vertical and horizontal networking opportunities and ultimately amplify their likelihood for growth. If an enterprise does not solve challenges associated with their growth opportunities exploitations then there is lower likelihood of optimizing their survival tactics. Some of the limitations experienced were in relation to study context. Most studies have been carried out among SMEs that differs from MSEs. The current study considered microfinance entrepreneurial services though banks such as KCB, Cooperative and Equity offers similar services to micro and small enterprises (MSEs). On conceptual framework, the current study considered external environment moderating effect in addition to the effect of microfinance entrepreneurial services on MSEs growth.

Since external environment can act as a source of competitive advantage there is need for micro and small enterprises develop measures aimed at attracting competitiveness among their competitors. Further, through involvement in external activities MSEs would be better placed in understanding their clients' needs and measures to be adopted to manage customer satisfaction and loyalty.

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